2011 Exam - Corporate Law

Question 1

a. s 259A states that a company must not acquire shares in itself. Does Axiom (A) control Security (S) as per s 259E? A company controls an entity if the company has the capacity to determine the outcome of the decisions about the entity's financial policies. S is a wholly owned subsidiary, therefore this is satisfied. s 259B(1) states that a company cannot take security over shares in itself or in a company that controls it. The exemptions of ss 259B(2) and (3) are not satisfied on the facts. S and A cannot do this; this transaction is therefore void under s 259C.

b. s 260A(1) states that a company may assist a person to acquire shares in itself if it:

(a) does not materially prejudice the interest of the company or its shareholders or the company's ability to pay its creditors; or

(b) has been approved by shareholders under s 260B; or

(c) is exempted under s 260C.

Given that A is solvent, it is likely that this financial assistance will not materially prejudice the company. There is an issue perhaps with regards to the interest rate being well below the current market rates for equivalent loans. A range of issues must be considered here, such as the health of the company's balance sheet, the credit worthiness of Jade etc. If this did not materially prejudice then (b) and (c) of s 260A would not be relevant. Otherwise, they are. The onus is on the board of Axiom to show that it did not materially prejudice or one of the other gateways is satisfied (*ASIC v Adler, Williams v ASIC).*

A could seek approval of the company's shareholders under s 260B. Otherwise, it could look to the exemptions under s 260C; but these are unlikely to be satisfied here. A is not a financier because it is a no liability company for mining purposes (s 9). As ordinary business would have to include providing finance (*Steen v Law).*

Question 2

a and b.

<u>Selective buy-back (s 257)</u>

Kilton could conduct a selective buy-back; it would be a selective buy-back because it isn't any of the other four kinds (s 9). A buy-back of all the preference shares is a selective buy-back. A selective buy-back must be approved under s 257D(1) by either:

(a) a special resolution of a general meeting with no votes being cast in favour by those whose shares are being bought back or their associates (ss 11, 15); or

(b) a resolution agreed to at a general meeting by all ordinary shareholders.

Here, Kilton could buy-back all of the company's preference shares if there was a special resolution at a general meeting with no votes being cast in favour by preference shareholders or their associates. The likelihood of this option working is not very high - the preference shareholders receive a cumulative dividend.

Selective reduction

Another option is a selective reduction involving a cancellation of the preference shares - it must be approved under s 256C(2), by:

* special resolution of a general meeting or a unanimous resolution of ordinary shareholders; and

* special resolution passed at a separate meeting of the shareholders whose shares are being cancelled.

The separate class meeting would involve the preference shareholders and must be separate from the general meeting (*Winpar Holdings).* The reduction must be fair and reasonable as per s 256B and must be consistent with class rights. It is consistent with class rights because it involves preference shareholders getting their capital returned first, even if they oppose it (*Scottish Insurance, Re Fowlers).* This is quite likely to happen.

Alter class rights

Another option is to alter the class rights of the preference shareholders. The constitution doesn't have a variation of class rights procedure, therefore s 246B(2) applies - class rights may only be varied or cancelled with the approval of a special resolution of the company and a special resolution passed at a meeting of members in the class. If this was successfully done, then the constitution could be changed or that clause with the preference dividend deleted. Alternatively, 75% of the votes of preference shareholder may consent in writing.

This is unlikely to occur because it is unlikely that the preference shareholders would vote to have their cumulative dividend removed from the constitution.

c.

- ss 246C(6) and perhaps s 254D(1).

Question 3

Walter

Walter is a non-executive director. He may have breached s 180(1) which states that

a director must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would if they were a director in the position and occupied the office held by the director. This is measured objectively but does take into account particular circumstances of the company, director etc (*Daniels v Anderson).* In *Daniels v Anderson*, it was stated that executive and non-executive directors should be contemplated slightly differently as executive directors are involved in the day-to-day management. It is likely that Walter has breached this. He doesn't even know much about the business.

Walter could try to use the business judgement rule to protect him under s 180(2). The judgement must be made in good faith, the director must have no material personal interest, have informed themselves about the matter and rationally believe the judgement is in the best interest of the corporation. It is unlikely that this will be satisfied; Walter did not inform himself about the subject matter.

Walter could argue reliance under s 189. This is of particular relevance to non-executive directors. He has relied on Nina, who under s 189(a)(iii) has authority to make such claims because she is responsible for the application programming.

Nina

Nina has breached the no-conflict duty. There must be real or sensible conflict (*Hospital Products*). The test in *Phipps v Boardman* is a that a reasonable person would think there was a real sensible possibility of conflict. It is alleged she has voted against this because she was turned down a job by Oslim. She has also breached s 181 because she has not acted in good faith and for a proper purpose. She fails to satisfy both. She has not acted honestly and the "substantial" purpose of her decision was not being hired by Oslim.

Nina should perhaps have disclosed her material personal interest under s 191 and given standing notice under s 192 but because it is a proprietary company, she did not need to abstain from voting.

Olivia

It doesn't appear on the facts that Olivia has breached any of her director's duties.

Peter

Peter would breach the no conflict and profit duties. His personal interests are coming into conflict with the interests of the company. With the no profit rule, there is an issue regarding the business opportunity rule - Peter has learnt of this opportunity through the company. He attended the seminar because he was a programmer for Fringe.

He may breach s 182 if he takes up the opportunity.

Remedies

K may pursue a civil penalty order, disqualification, an injunction or compensation if it chooses to, through the use of a Declaration of Contravention for any breach of civil penalty provisions that have occurred. Peter could bring an SDA under s 237 in the name of the company. He would need leave under s 236 - he could satisfy this if:

(a) it is probable that the company will not sue; and

(b) he is acting in good faith; and

(c) it is in the best interests of the company that leave be given; and

(d) there is a series question to be tried; and

(e) either

(i) at least 14 days written notice was given to the company

(ii) it is appropriate to give leave nevertheless

Peter would likely satisfy this - he has good faith *(Swansson v Pratt)* because he genuinely believes that the decision not to enter the market was a mistake.

The court can make any order it considers appropriate and orders for costs (ss 241 and 242).

Question 4

i. Orpheus must follow the procedure for distribution of assets in the Corporations Act. The first priority in winding up is proprietary and secured claims over property, subject to floating charge subordination (s 561). TroyLoans Ltd is owed $200,000 by Marble. $100,000 of this is a fixed charge and the rest is secured by a floating charge. Therefore, TroyLoans has a first ranking priority with regards to the $100,000 fixed charge. It can take possession of the freehold premises and sell it. The floating charge is covered under s 561 - where the property of the company being would up is insufficient for payment of all unsecured creditors, employees debts will have priority. Assets covered by the floating charge can be used to pay employees.

Next is priority of debts under s 556. This must be followed by Orpheus. The first claim to be repaid is remuneration of the liquidator (s 556(de)). It is a deferred expense as defined by s 556(2). The next claim to be repaid is Pericles salary under s 556(e). it is capped under s 561 but is still a priority claim up to $2,000.

After this, the floating charge can be paid to the bank, because s 556 is satisfied. Employees (here, Pericles salary) have been paid. The bank would be able to sell the rest of Marble's business. Last to be paid will be Xenephone because it ranks pari pass amongst unsecured creditors. This is under ss 501 and 555. Unsecured

creditors must rank equally and proportionately.

Last in this process is shareholders (s 563A).

ii. This is an uncommercial transaction. Under s 254T, Marble could declare the dividends because the company was solvent at the time and its assets would have exceeded its liabilities.

Under s 588FB(1), a transaction is an uncommercial transaction if a reasonable person in the company's circumstances would not have entered into the transaction having regard to:

(a) the benefits; and

(b) detriment to the company; and

(c respective benefits; and

(d) any other matter.

This is likely to be satisfied here. The company was already insolvent. A reasonable director would not have done this.

There is also an unfair preference under s 558FA(1) because it is more than Zeus would've got if he had to prove payment along with other unsecured creditors.

The clawback period here is therefore 2 years (s 558FE(3)) because the transaction is an unfair preference and uncommercial transaction. Zeus would have to claim a defence under s 588FG - that the transaction was entered into in good faith, no reasonable grounds for suspecting the company was insolvent, reasonable person in these circumstances would not have expected insolvency at the time and provided valuable consideration. The "but for" test would be applied here.

It is likely Pericles is guilty of insolvent trading under s 588G. it is very unlikely that he would satisfy any of the defences under s 588H.

Question 5

i. Voluntary administration - the purpose (s 435A) is to provide for the business, property and affairs of an insolvent company to be administered in a way that maximises the chance of the company, or as much as possible of its business, continuing in existence, or at least a better return for the company's creditors in winding up.

An administrator can be appointed by the directors under s 436. Initiating an early voluntary administration may also help as a defence under s 588H(6) or s 588H(5) as steps take to prevent incurring debt.

The voluntary administration will place an automatic stay/moratorium (ss 440D and F) until the second creditors meeting, which can often be extended with court approval.

Voluntary administration is more positive - it is done with the aim of potentially saving the business.

ii. Trustees bank is able to appoint Caesar as a receiver because it is a security holder with a charge over all or substantially all of the company's property (s 441A). The bank has special rights under the voluntary administration. The bank must appoint the receiver within the 13 day decision period, after the notice has been served. If they appoint a receiver to recover then this is subject the the administrator's power to go to the court and restrain the power. If they don't appoint the receiver within 13 days, they cannot appoint a receiver after this decision period without court or administrator permission.

It is a precondition of appointment of a receiver under s 441A that the charge has become and is still enforceable.

The default event in the security document has been satisfied and demands for payment have 'fallen on deaf ears' so the bank can appoint Caesar as receiver in its capacity as charge holder.

iii. It is very likely that R & R have participated in insolvent trading because they started having financial problems 12 months ago and these have been worsening since.

This would mean they have contravened s 588G. There are four defences

* reasonable grounds to expect solvency - s 588H(2)
* reasonable reliance as to solvency provided by others - s 588H(3)
* non-participation in management - s 588H(4)
* reasonable steps to prevent incurring debt - s 588H(5)

These are not likely to be satisfied on the facts. The only defence that would perhaps be satisfied by R&R is that they took reasonable steps under s 588H(5) e.g. buying the book or going into VA (s 588H(6)). The book is unlikely to satisfy; they should've sought professional advice.

R&R may also be relieved under s 1317S if they acted honestly and ought fairly be excused. This appears to be satisfied on the facts. The economic problems in Italy could have been the cause of temporary financial struggles and it was perhaps reasonable for them to believe the food festival would've helped. The book is probably not sufficient though.

Ron could perhaps claim he relied on advice from Rem under s 588H(3) and as in *Stakeman.*